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No. 06-1468

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IN THE

Supreme Court of the United States

DYNEGY POWER MARKETING, INC., *ET AL.*,
Petitioners,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

The Ninth Circuit's decision can be reconciled with neither *Mobile* and *Sierra*, nor the decisions of other circuits applying those cases. The decision, moreover, casts doubt on billions of dollars' worth of contracts and creates a pall of uncertainty over when future contracts will be subject to regulatory or judicial second-guessing—precisely what the *Mobile-Sierra* doctrine was designed to avoid.

Respondents either do not address, or seek to minimize, these issues. Not one defends the Ninth Circuit's primary basis for refusing to apply *Mobile-Sierra* to the Dynegy contract—that *Mobile-Sierra* is inapplicable where FERC "accepts" rather than "approves" rates for filing (Pet. App. 11a-12a). Their refusal to defend the Ninth Circuit's reasoning is unsurprising; the very same language the Ninth Circuit relied on here also appeared in the agency orders at issue in *Mobile* and *Sierra* themselves. The Ninth Circuit's flawed and undefended ruling on this point also squarely conflicts with decisions of the First and D.C. Circuits (Pet. 14-17). That is reason enough to grant the petition.

Respondents' attempt to invoke alternative grounds fares no better. Those grounds are not independent, do not diminish the importance of the Ninth Circuit's decision on this issue, and are themselves equally worthy of review. The Ninth Circuit did not merely "elaborate" on *Mobile-Sierra*; the Ninth Circuit eviscerated it. The court stated that *Mobile-Sierra* does not apply when new information about the extent of "market dysfunction" emerges—and that *Mobile-Sierra* thus did not apply here because, at "the time Dynegy filed its contract, the full scale" of "market dysfunction was not nearly as fully known as it is today." Pet. App. 11a-13a. It further held that FERC must set aside contracts whenever agreed-upon prices are above a "zone of reasonableness." *Id.* at 14a-15a. *Mobile-Sierra* cannot accomplish its purpose of providing contractual certainty if parties must speculate whether their bargains will

be repudiated based on such notions. Those faulty standards, which create a conflict with other circuits (Pet. 19-20, 23-26), warrant review.

While FERC asserts that it has "sufficient discretion" on remand under the Ninth Circuit's decision (U.S. Br. in Opp. 12; see Snohomish Br. in Opp. 1), *Mobile-Sierra* is designed to *restrict FERC's* authority. That FERC may not be challenging the doctrine's evisceration is thus no reason to deny review. And while FERC urges a wait-and-see approach—speculating that the Ninth Circuit's decision may be confined to the "unique" circumstances of the particular energy crisis at issue here—industry participants cannot be so sanguine. They should not be forced to endure the very sort of contract uncertainty that *Mobile-Sierra* was designed to prevent.

ARGUMENT

I. RESPONDENTS OFFER NO VIABLE DEFENSE OF THE NINTH CIRCUIT'S HOLDING THAT *MOBILE-SIERRA* IS INAPPLICABLE TO CONTRACTS THE COMMISSION "ACCEPTS" BUT DOES NOT "APPROVE"

The Ninth Circuit's first and primary basis for not applying *Mobile-Sierra* in Dynegy's case was that, although Dynegy filed its contract with FERC, FERC's order merely "accepted" the contract for filing and "did not give prior *approval* to the Dynegy contract." Pet. App. 12a (emphasis added). As Dynegy has explained (Pet. 12-17), that holding conflicts with decisions of the First and D.C. Circuits, which accord *Mobile-Sierra* protection to contracts that have been accepted but not approved. And it is irreconcilable with *Mobile* and *Sierra* themselves, *both* of which involved orders with identical language accepting the contracts for filing but not approving them. Pet. 17-18 & n.8.

Respondents never address, much less rebut, that showing of a clear circuit split. Nor do they attempt to defend the Ninth Circuit's decision on the merits. Instead, California invents an alternative rationale the Ninth Circuit did

not accept—that Dynegy's filing was merely "informational" and thus did not offer an "opportunity for the public to seek individualized review," Cal. Br. 13-14 n.8. But the only authority California cites, *GWF Energy, LLC*, 97 FERC ¶ 61,297 (2001), supports Dynegy's position. In *GWF*, FERC's order *expressly stated* that FERC was accepting the contract only "for informational purposes." *Id.* at 62,392; see also *Long Beach Generation LLC*, 120 FERC ¶ 61,297 (2007). Here, by contrast, FERC's order accepting the Dynegy contract did *not* include any such language. *GWF* proves that FERC knows how to say it is accepting a filing "for informational purposes" when that is what it means to do. It thus comes as no surprise that the United States (representing FERC) both declines to defend the Ninth Circuit's distinction between "accepting" and "approving" a filing, and declines to endorse California's new theory that Dynegy's filing was merely "informational." See U.S. Br. 14 n.2. That even the expert agency charged with administering the statute does not endorse California's argument speaks volumes about its merits.

California's claim that there was no "opportunity for the public to seek individualized review" is impossible to reconcile with the fact that, after Dynegy's contract was submitted, the CPUC and CEOB intervened in proceedings before FERC and litigated the case to finality in 2001. *Dynegy Power Mktg., Inc.*, 95 FERC ¶ 61,371 (2001). They *chose* to raise "no substantive issues," *id.* at 62,401, even though they were strenuously arguing in other cases that the California electric market was dysfunctional, Pet. 5-6. Having already litigated the contracts before FERC once, California cannot plausibly claim it had no opportunity to address these issues before.

In any event, no respondent denies that the Ninth Circuit created a square circuit conflict on this issue. The D.C. and First Circuits have both held that *Mobile-Sierra* applies to contracts that are accepted for filing. Pet. 15. In the Ninth Circuit, by contrast, it is now the law that mere

"acceptance" of a contract for filing is insufficient. Pet. App. 11a-12a. That issue is no less pressing merely because the Ninth Circuit purported to offer *other* erroneous grounds for vacating FERC's order (U.S. Br. 14 n.2; Cal. Br. 13-14 n.8). That holding now applies in *every* case where FERC merely "accepts" a contract for filing, whether or not FERC also commits the other supposed "errors" the Ninth Circuit identified. In any event, as shown below, the other "errors" identified by the Ninth Circuit are independently worthy of review. Indeed, they all derive from the same false premise—that *Mobile-Sierra* implements a doctrine based on prior regulatory approval rather than one that respects voluntary agreements between sophisticated parties. The Court thus should settle the circuit split on this important and broadly recurring issue.[1]

II. *MOBILE-SIERRA* IS NOT INAPPLICABLE MERELY BECAUSE PARTIES LATER HAVE BETTER INFORMATION THAN WHEN THEY AGREED TO A CONTRACT

This Court should also grant the petition to review the Ninth Circuit's erroneous holding that, even where a contract is properly filed with FERC, *Mobile-Sierra* is inapplicable if "the full scale of spot market manipulation and forward market dysfunction was not nearly as fully known" at the time of contracting as it is today. Pet. App. 12a. That ruling is particularly pernicious here because, at the very time California executed the contract with Dynegy, it was claiming market dysfunction in other proceedings. Pet. 5-6. The Ninth Circuit's holding thus allows parties to avoid *Mobile-Sierra*—and escape bargained-for agreements—

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[1] Although FERC's new market-rate program relieves many entities of the obligation to file contracts in favor of periodic reporting, the issue remains vitally important for those regions and participants that no longer qualify for market-rate authority and must file long-term contracts with FERC. See *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity, & Ancillary Servs. by Pub. Utils.*, Order No. 697, FERC Stats. & Regs. ¶ 31,252 paras. 91, 659 (2007), reh'g pending (codified at 18 C.F.R. Part 35).

merely because more information later emerges about the *extent* of an already known risk.

The Ninth Circuit's holding conflicts with the First Circuit's decision in *Northeast Utilities Service Co.* v. *FERC*, 993 F.2d 937 (1st Cir. 1993) ("*NUSCO I*"). *NUSCO I* holds that, while market power (one form of market dysfunction) may be relevant to the public-interest analysis conducted *under Mobile-Sierra*, it is not a basis for refusing to apply *Mobile-Sierra* in the first place. Pet. 19-20. That was precisely the approach FERC took here—it looked at the extent of market dysfunction when applying the public-interest analysis under *Mobile-Sierra*, rather than treating it as a precondition to applying *Mobile-Sierra*. U.S. Br. 16-17. And that was precisely the approach the Ninth Circuit rejected. Pet. App. 12a-13a.

The United States claims that *NUSCO I* is "consistent" with the decision below because, on remand there, FERC considered market power as a factor *under Mobile-Sierra* and the First Circuit affirmed that later order in *Northeast Utilities Service Co.* v. *FERC*, 55 F.3d 686 (1st Cir. 1995) ("*NUSCO II*"). But there is a fundamental difference between considering market power or dysfunction *as part of* the *Mobile-Sierra* analysis, and citing such factors as a reason *not to apply Mobile-Sierra* at all. When market dysfunction is considered *under Mobile-Sierra*, it is one of many factors; FERC will still uphold a contract despite market dysfunction if, on balance, the demanding public interest test has not been satisfied. Under the Ninth Circuit's approach, by contrast, market dysfunction (more specifically, new information about the *extent* of dysfunction) is, *standing alone*, grounds for rejecting *Mobile-Sierra* and applying a "just and reasonable" standard instead.

The United States' claim that these approaches may be indistinguishable is belied by the result in this very case. FERC *did* consider market dysfunction *under* the *Mobile-Sierra* standard (U.S. Br. 16-17), but the Ninth Circuit

overturned its order. If the distinction is of no moment, why did the Ninth Circuit vacate and remand? Respondents offer no answer. The United States' theory of "no difference" is also belied by *NUSCO*. In *NUSCO I*, the First Circuit *remanded* FERC's order when FERC relied on market power as a reason to apply the "just and reasonable" standard rather than the "public interest" standard, 993 F.2d at 962; in *NUSCO II*, the First Circuit *affirmed* FERC's order after FERC made more extensive findings that justified overturning the contract *under* the "public interest" standard. Those approaches clearly are not interchangeable. Because the Ninth Circuit adopted one (making market dysfunction a reason to refuse to apply *Mobile-Sierra*) and the First Circuit chose the other (holding that dysfunction can only be considered when applying *Mobile-Sierra*), this Court's review is warranted.

The Ninth Circuit's decision, moreover, is incorrect. Where parties enter into a fixed price contract with imperfect information, the contract necessarily allocates the risk that one side or the other will regret its decision when additional information later comes to light. Pet. 22 & n.11. Here the CPUC and CEOB had alleged that there was market dysfunction and manipulation even as California was entering into the Dynegy contract. Pet. 5-6 & n.3. By entering into the contract, California purchased certainty in the face of that and other unknowns. If the dysfunction turned out to be *less* widespread than the parties estimated, Dynegy would not have been permitted to invoke that hindsight to escape its obligations to California. By the same token, California cannot rely on those known risks as a reason to repudiate *its* bargain. Unless *Mobile-Sierra*'s demanding public interest test is met, sophisticated parties in an arms' length contract must live with the allocation of risks—particularly identified risks—they establish in their contracts.

The Ninth Circuit's approach also ignores bedrock principles of finality. Where a contract is filed with FERC, the

resulting proceedings offer interested parties their exclusive opportunity to challenge the justness and reasonableness of the contract. Pet. 21. Litigants cannot reopen final FERC decisions merely because they later discover new information that affects their valuation of a contract. Yet that is exactly what the Ninth Circuit allowed here.

III. The Ninth Circuit's Reconfiguration Of The Public Interest Test Conflicts With Decisions Of Other Circuits

Finally, this Court should review the Ninth Circuit's holding that FERC must set aside contracts under *Mobile-Sierra* merely because the price is above some ill-defined "zone of reasonableness." Pet. App. 13a-15a. As the Ninth Circuit candidly acknowledged, its holding establishes a double standard between high-rate and low-rate cases. Pet. App. 13a-15a. Notably, the United States does not deny the existence of a circuit split on this issue. And although California and Snohomish expend considerable effort attempting to obscure the conflict, their efforts fall short.

The decision below directly conflicts with *Potomac Electric Power Co.* v. *FERC*, 210 F.3d 403 (D.C. Cir. 2000), which applied the traditional *Mobile-Sierra* standard to a high-rate contract challenge by a buyer of transmission services. Pet. 23-24. Although respondents argue that *Potomac Electric* merely involved a failure of proof (Cal. Br. 24; Snohomish Br. 22), the D.C. Circuit made clear that the applicable standard was the traditional *Mobile-Sierra* public-interest standard applied in typical low-rate cases. *Potomac Electric*, 210 F.3d at 412 (citing *Sierra*, 350 U.S. at 355). The decision below, by contrast, insists that an entirely different public-interest standard applies.

Snohomish attempts to distinguish *Public Service Commission of New York* v. *FPC*, 543 F.2d 757 (D.C. Cir. 1974) ("*PSCNY*"), urging that the court in that case allowed FERC to impose a lower rate than the parties had sought. Snohomish Br. 22-23. But that lower rate was an initial price condition on the grant of a Section 7 certificate, which,

as the court recognized, "does not ordinarily implicate the *Mobile-Sierra* rule." 543 F.2d at 794. Later contract modifications by FERC *were* invalidated under *Mobile-Sierra*, because "[e]xcept as the exigencies of the public interest demanded, the Commission was *no more at liberty to alter the lease-sale contract to the prejudice of the producers than to do so in their favor.*" *Id.* at 798 (emphasis added).

Equally unavailing is Snohomish's claim (Br. in Opp. 23) that *PSCNY* is inapplicable because it concerned only "a contract between natural gas producers and pipelines, with no clear implications for ultimate gas consumers." As the court in *PSCNY* was well aware, 543 F.2d at 771, the purchaser was a price-regulated entity that would have had to pass through the bulk of its savings to its customers. *PSCNY* too directly conflicts with the decision below.[2]

The Ninth Circuit also established an indefensible rule. California and the consumers it represents had ample opportunity to challenge the "reasonableness" of Dynegy's rates in the proceedings following the filing of Dynegy's contract with FERC. Those proceedings were litigated to finality. Parties to a contract should not be permitted to return to FERC years later and seek to rewrite a contract for no better reason than that the rates now seem above the "zone of reasonableness" in hindsight. To allow buyers, but not sellers, to bring such challenges is doubly unfair. *Mobile-Sierra* prescribes no such one-sided rule.

IV. THESE IMPORTANT AND RECURRING ISSUES WARRANT IMMEDIATE REVIEW

All three questions presented by the petition are recurring and important. Although respondents and the United States claim otherwise—asserting that the California energy crisis was a unique historical event—the Ninth

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[2] California cites (Br. in Opp. 22-23) a 50-year old Fourth Circuit case for the proposition that buyers are subject to a different standard than sellers. Far from diminishing the importance of the issue, however, that case deepens the conflict and thus underscores the need for review.

Circuit's decision offers no such assurances. Nothing in the Ninth Circuit's decision suggests that its distinction between rates that are merely "accepted" and those that are "approved," see Pet. 14-17; pp. 2-4, *supra*, is somehow limited to litigation arising out of the California energy crisis. For years, FERC has been "accepting" rates without "approving" them (as it did in *Mobile* and *Sierra* themselves). The Ninth Circuit's holding casts doubt on all those contracts.

Likewise, the Ninth Circuit's other holdings do not purport to be limited to cases arising from the California energy crisis. "Market dysfunction" is an amorphous concept that is easy to allege, particularly in the notoriously volatile energy markets. It can be difficult to distinguish between the effects of legitimate scarcity, market fundamentals, and manipulation. If the Ninth Circuit's decision is affirmed, disappointed buyers will have powerful incentives to challenge contracts whenever new information about market conditions emerges that could plausibly be described as "dysfunction," or whenever agreed-upon prices seem too high in retrospect. The fact that FERC may eventually reject some challenges will not spare sellers from the costs of defending their contracts in litigation. The result will be precisely the contractual uncertainty and instability that *Mobile-Sierra* was meant to avoid.

The electric industry requires massive new capital investment in the coming years—hundreds of billions of dollars—to meet anticipated consumer demand. EPSA Br. 8–14; CEA Br. 8–13; ISDA Br. 16–18. The gas industry also faces similar contractual uncertainty. INGAA Br. 3-4. Investors will be far less willing to finance new energy infrastructure projects if they can only speculate whether their contracts will be honored. *Ibid.* As a result, the ultimate losers will be consumers themselves: California's temporary "rolling blackouts" were nothing compared to the consequences of an energy industry that, because of

payment uncertainty, cannot develop capacity to meet consumer demand.

Even if the Ninth Circuit's holding were later limited to "crisis" situations, the case would still be a matter of profound public interest—even apart from the uncertainty that would persist until that limitation actually occurred. California's energy crisis was severe, but it will not be the last time that the energy markets—electric and gas—are confronted with fluctuating prices and uncertainty. If suppliers know their contracts will be honored, they can help buyers reduce that uncertainty by offering long-term contracts at fixed prices. Those risk-reducing contracts are most valuable *precisely when* markets are in a state of rapid flux. But if the Ninth Circuit's decision stands, no rational supplier would enter into such a heads-I-win, tails-you-lose agreement (particularly because any additional risk premium would simply be cited as evidence of unreasonable pricing). Absent suppliers willing to deal, energy purchasers will be denied the ability to hedge their risks (at least absent exorbitant premiums to compensate for legal risks) precisely when the ability to hedge matters most. The losers will be consumers themselves.

Finally, regardless of the Ninth Circuit decision's *prospective* impact, these cases are important even on a stand-alone basis. As California acknowledges, the amount at stake in the *PUC* case alone is a *minimum* of $1.4 billion. Cal. Br. 7. While FERC may prefer to urge the Court to wait and see how the Ninth Circuit's ruling plays out in future cases (U.S. Br. 17-18), the contracts at issue represent real money that California agreed to pay petitioners but is now seeking to recoup, with the Ninth Circuit's blessing. That alone is reason enough to grant the petition and settle the important legal questions presented.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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